



THE ROBERT SCHUMAN CENTRE

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Balancing Positive and
Negative Integration:
the Regulatory Options
for Europe

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The Regulatory Options for Europe

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1. *Integration and the Loss of Problem-Solving Capacity*

During the golden years from the 1950s to the mid-1970s, the industrial nations of Western Europe had the chance to develop specifically national versions of the capitalist welfare state — and their choices were in fact remarkably different (Esping-Andersen 1990). In spite of the considerable differences between the “Social-Democratic”, “Corporatist” or “Liberal” versions, however, all were remarkably successful in maintaining full employment and promoting economic growth, while also controlling, in different ways and to different degrees, the destructive tendencies of unfettered capitalism in the interest of specific social, cultural, and/or ecological values (Scharpf 1991a; Merkel 1993). It was not fully realized at the time, however, how much the success of market-correcting policies did in fact depend on the capacity of the territorial state to control its economic boundaries. Once this capacity is lost, countries are forced into a competition for locational advantage which has all the characteristics of a Prisoner’s Dilemma game (Sinn 1994). It reduces the freedom of national governments and unions to raise the regulatory and wage costs of national firms above the level prevailing in competing locations. Moreover, and if nothing else changes, the “competition of regulatory systems” that is generally welcomed by neoliberal economists (Streit/Mussler 1995) and politicians, may well turn into a downward spiral of competitive deregulation and tax cuts in which all competing countries will find themselves reduced to a level of protection that is in fact lower than preferred by any of them.

While *economic* competition has increased globally, the member states of the European Union also find themselves subjected to a wider range of *legal* constraints that are more effectively enforced than is true under the worldwide regime of the GATT and the WTO. These requirements of “negative integration” are derived from the commitment, contained in the original Treaties and reinforced by the Single European Act, to the free movement of goods, services, capital and workers, and to undistorted competition throughout the Community. In the abstract, the basic commitment to create a “Common Market” was certainly shared by the governments that were parties to the Treaties and by the national parliaments that ratified these agreements. What may not have been clearly envisaged were the doctrines of direct effect and supremacy of European law that were early on established through decisions of the European Court of Justice. Once these doctrines were accepted, the Commission and the Court of Justice had the opportunity to continuously expand the scope of negative integration without involving the Council of Ministers. As a consequence, national policy makers now find themselves severely constrained in the choice of policy instruments as they try to cope with rising levels of mass unemployment and other manifestations of a deepening crisis of the European welfare state.

At the same time, there is now a deep skepticism regarding the original hopes, in particular on the part of unions and the parties associated with them, that regulatory capacities lost at the national level could be re-established through "positive integration" at the European level. While negative integration was advanced, as it were, behind the back of political processes by the Commission and the Court, measures of positive integration have always required the explicit agreement of national governments in the Council of Ministers. As long as the Luxembourg Compromise still applied, the price of unanimity was an extremely cumbersome decision process. The Single European Act of 1986 was supposed to change this by returning, for harmonization decisions "which have as their object the establishment and functioning of the internal market" (Art. 100A), to qualified-majority voting in the Council. However, rules are adjusted in such a way that the opposition of even small groups of countries united by common interests can rarely be overruled.¹ In any case, the veto remains available as a last resort even to individual countries, and the unanimity rule still continues to apply to a wide range of Council decisions. Thus, the need for consensus remains very high for measures of positive integration, and when national interests are in serious conflict, Europe is unable to act at all.

Such conflicts are likely to arise from differences among member states in the levels of economic development — and hence differences in the average productivity of firms and in the ability to pay of consumers. They will also arise from differences in institutional structures, and hence differences in the cost of adjustment if one of the other national model were chosen for uniform European solutions. In addition, there are also ideological differences among governments, regarding either the division between the market and state functions, or the division between national and European policy responsibilities. In short, agreement is difficult to reach, and disagreement and hence policy blockage quite likely when positive integration is attempted (Scharpf 1996).

As a result, national problem-solving capacities are reduced by the dual constraints of more intense economic competition and by the legal force of negative integration, while European action is constrained and often blocked by conflicts of interests under decision rules imposing very high consensus requirements. There is a real danger, therefore, that in the face of rising levels of crisis the manifest helplessness of governments at the national and at the European level

¹ Conversely, of course, even large majorities cannot have their way. It is important to realize, in other words, that the qualified majority and unanimity rules have extremely asymmetric consequences — favoring inaction and reducing the chances of success of policy initiatives departing from the status quo.

will undermine the legitimacy of democratic government as it had done in some countries in the Great Depression of then 1930s.

2. *European Support for National Solutions?*

There is thus every reason to search for options at both levels that could increase problem-solving effectiveness even under conditions of international competition and high consensus requirements. This paper will focus on the latter possibility. I am convinced, however, that the main burden must be carried by national governments which, even though constrained by the legal prohibitions of negative integration in Europe and by the economic pressures of regulatory and tax competition in the integrated market, are by no means helpless. There exist, as I have shown elsewhere, *national* solutions in the critical fields of employment, social policy, and taxation that are more robust to the challenges of economic integration and systems competition than is true of present policy patterns (Scharpf 1997). It is also true, however, that many of these solutions would require far-reaching and deep-cutting policy changes and institutional reforms on a scale that can only be compared to those brought about by the Conservative government in Britain. But 18 years of single-party rule are hard to imagine in other European countries — in many of which, moreover, multi-party government coalitions, federalism, corporatism, judicial review and central-bank independence create many more ‘veto points’ in the political process than is true in Britain (Tsebelis 1995). Hence even if national solutions are available in principle, it is unlikely that they could be speedily adopted and implemented everywhere.

In any case, high and rising levels of mass unemployment, tightening fiscal constraints and the growing pressure of political dissatisfaction and, in some countries, political radicalization, are not generally conducive to the longer-term perspective required by institutional reforms of a fundamental nature. Moreover, even if national policy makers were not incapacitated by internal conflicts and the myopia of crisis politics, they would still be struggling, as it were, with one arm tied behind their backs by the legal constraints of European competition policy and regulatory competition against other member states — both of which tend to create enormous comparative advantage in domestic politics for political parties and interests favoring the dismantling, rather than the reconstruction, of welfare state institutions. Thus, if the social achievements of the postwar decades should at all be defended under the conditions of globalized markets and European economic integration, there is a reason for exploring the ways and means through which national efforts can be facilitated

and supported by policies at the European level that can be adopted even under decision rules requiring near-unanimous agreement.

The Treaty of Amsterdam has done little to increase the general capacity for 'positive integration' and effective European problem solving in the face of unresolved conflicts of interest or of ideology among member governments. The President of the Commission, it is true, will be strengthened by having a voice in the appointment of Commissioners, and the European Parliament is strengthened by a considerable expansion of the items on which it has an effective veto under the co-decision procedure. But no agreement has been achieved with regard to voting rules in the Council of Ministers — instead, even countries like Germany and France, that in the past have promoted majoritarian decision rules, now seem to have been more concerned about the risk of being outvoted in an enlarged Community.

Nevertheless, the Amsterdam Summit produced some compromises that represent moves in the right direction - forward on employment policy and backward (or more cautiously forward) on negative integration. After considering the possible implications of these agreements, I will then turn to European options not discussed, or not accepted, at Amsterdam - which, however, are of a kind that should be sufficiently compatible with the interests of national governments to make further consideration worthwhile.

3. *Coordinated National Action on Employment?*

The Amsterdam agreements on employment have generally been criticized as compromises on the level of the lowest common denominator, or as exercises in symbolic politics (Wolter/ Hasse 1997). They may in fact turn out to be just that, and they have certainly disappointed those among their promoters who had hoped for a commitment to Keynesian full employment policies, pursued through Community programs initiating large-scale infrastructure investments. But what was agreed upon may in fact have more positive implications than a return to the deficit-spending philosophy of the 1970s could have had.

A 'New Title on Employment' will now be included in the Treaty of the European Communities. Its Article 1 commits the member states to 'work towards developing a coordinated strategy for employment'; Article 2 defines 'promoting employment as a matter of common concern', and Article 4 requires each member state to provide the Council and the Commission with an 'annual report on the principal measures taken to implement its employment policy' — on the basis of which the Council may 'make recommendations to Member States'.

Moreover, the Council will establish an 'Employment Committee' that is to 'monitor the employment situation and employment policies' in the member states and to formulate opinions in preparation of Council proceedings. Taken together, these provisions hold three important promises.

First, by declaring national employment policies a matter of common concern of all member states, and by creating the organizational and procedural conditions for monitoring and evaluation, the Amsterdam Treaty may, for the first time, provide some safeguards against the temptation of all countries to protect domestic jobs through 'beggar-my-neighbor' policies, competitive deregulation and tax cuts. In the past, certainly, European governments have observed and responded to each others' moves: If Britain had deregulated labor markets, the Netherlands did extend the limits on temporary employment, and Germany eliminated employment security in firms with ten or fewer employees. Similarly, when France chose to reduce employers' contributions to social insurance, Germany and Sweden did cut sick pay, and Germany is now lowering pension levels and requiring patients to bear part of their health care expenses in order to reduce non-wage labor costs. If others then respond again, all players in the European competitiveness game may find themselves at lower levels of social protection without having improved their relative position. While I am not suggesting that all of these competitive stratagems should have been prevented, it nevertheless could have been very useful to have them examined internationally.

Second, the commitment to compare and evaluate national policies with a view to share information about 'best practices', and to promote 'innovative approaches' (Article 5) creates conditions that are conducive to the joint discussion of structures and causes of employment problems, and to the joint exploration of employment policy options at the national level. Since these discussions in the reconstituted 'Employment Committee' of the Council will be more detached from immediate political pressures and acute crises than is true of national politics, there is a hope that innovative solutions to common problems could be worked out that would not have been found in the rough-and-tumble of competitive party politics dominating national policy processes. Given an active role of the Commission, and opportunities for 'deliberative' interactions in a permanent committee of senior civil servants, there is at least a chance that an understanding of the causes of the 'European employment gap', and of potentially effective employment strategies, could emerge that go beyond the ubiquitous recipes of the OECD Jobs Study (1994), for labor market deregulation, public-sector retrenchment, and the reduction of social benefits.

Last, but by no means least, the explicit postulation of an employment goal, coequal with the fundamental commitment to the four freedoms of the internal market, may have beneficial effects against the dominance of neo-liberal interpretations of what European integration is about in the practice of the Commission and in the decisions of the European Court of Justice. At any rate, it will now be harder to argue that, as a matter of positive law, the Community should be strictly limited to achieving, and protecting, the 'four freedoms' and undistorted market competition (Mestmäcker 1987; 1994). In this regard, it may also help that the Treaty now incorporates the full set of fundamental rights guaranteed by the 1950 European Convention for the Protection of Human Rights and Fundamental Freedoms as well as a more explicit commitment to 'a high level of protection and improvement of the quality of the environment'. What is to be hoped for, in other words, is a reconsideration of the legal scope of negative integration in the light of social and political goals other than the maximization of market competition.

4. *Limits on Negative Integration*

As a matter of fact, Amsterdam has taken some very explicit steps in that direction, and there have also been Council directives and decisions of the European Court of Justice which have had the effect of limiting the reach of negative integration in order to protect national solutions that could otherwise be challenged as violating the prohibition of non-tariff barriers to trade, as interfering with the free movement of services, or as competition-distorting state aids or regulations.

4.1 Amsterdam Agreements

At the Amsterdam Summit itself, some sort of agreement was reached on three issues arising from the extension of European competition law into service areas 'affected with a public interest'. The first, and potentially most far-reaching, will include a new Article 7d in the Treaty whose delicately diplomatic formulations are worth being quoted in full:

Without prejudice to Articles 77, 90 and 92, and given the place occupied by services of general economic interest in the shared values of the Union as well as their role in promoting social and territorial cohesion, the Community and the Member States, each within their respective powers and within the scope of application of this Treaty, shall take care that such services operate on the basis of principles and conditions which enable them to fulfill their missions.

On its face, this clause, that had long been promoted by public-service associations (Villeneuve 1997) and the French government, seems to lack any operative content — which may be due to political disagreement among member governments over the legitimate scope of a *service-public* exemption from European competition law. But even if the Council had been of one mind, it would have been difficult to constrain the scope of negative integration in a general way. Since the Commission and the Court had extended that scope in a case-by-case process of individual decisions, each of which was accepted and implemented as the law of the land by the governments immediately affected, the Council could neither enact a wholesale reversal of past decisions nor could it formulate a clear-cut rule that would satisfy, for an unknown variety of future cases, the equally legitimate interests in reducing economic protectionism and in protecting the substantive ‘missions’ of various *service-public* institutions. Since the relative importance of these potentially conflicting concerns must be determined with a view to the specific circumstances of concrete cases, the Council could only signal to the Commission, the Court² and the legal profession that — in light of the ‘shared values of the Union’ — more weight ought to be given to the purposes served by public-service missions. Whether that signal will be respected or ignored is largely beyond the Council’s control.³

The Amsterdam Summit sent a similar signal by its ‘Protocol to the TEC’ regarding public service broadcasting which, rather than amending the text of the Treaty, reminds Commission and Court that ‘the system of public broadcasting in the Member States is directly related to the democratic, social and cultural needs of each society’, and then goes on to formulate ‘interpretative provisions’ according to which the Treaty does not rule out the funding of public service broadcasting. Again, however, the assertion is qualified by the proviso ‘that such funding does not affect trading conditions and competition in the Community to an extent which would be contrary to the common interest...’

² That the message is indeed intended for the Court is also made clear by a ‘Declaration to the Final Act’ which stipulates that ‘The provisions of Article 7d on public services shall be implemented with full respect for the jurisprudence of the Court of Justice, inter alia as regards the principles of *equality of treatment, quality and continuity of such services*’ — principles that is, which the Court itself had on occasion accepted as justification for *limiting* the reach of European competition law.

³ There is, of course, the possibility that national governments might influence the Commission by twisting the arms of ‘their’ commissioners and the members of their cabinets (Schmidt 1997). But that option was always considered highly inappropriate (Ross 1995), and it will become less effective, now that the President of the Commission must agree to the appointment (and reappointment!) of individual commissioners.

The same is true in the third instance of a 'Declaration to the Final Act' in which the Intergovernmental Conference notes that 'the Community's existing competition rules' are not violated by the existence of, and the facilities granted to, public credit institutions in Germany — an assertion which once more is followed by the qualification that such 'facilities may not adversely affect the conditions of competition to an extent beyond that required' by the infrastructure functions of these institutions. In other words, the Commission and the Court will retain their role in balancing competing principles in specific cases, but they have now been alerted to the importance of some of the countervailing values to be considered. That effect should not be underestimated — but it is far removed from a reassertion of direct 'intergovernmental' control over the functions delegated to the Commission and the Court of Justice. In the field of negative integration, these 'agents' will continue to play their 'supranational' roles (Garrett 1995; Mattli/ Slaughter 1995), but they do so in the context of a political discourse with governments and the Council over the proper performance of that role.

Council Directives

In areas where hard and fast rules can be defined, it is of course possible to limit the impact of negative integration more directly through the adoption of Council directives — provided that the Commission is willing to take the initiative, and that the directive is not blocked through conflicts of interest among member governments within the Council itself. An example is the 'posted workers directive' (96/71/EC) adopted after many years of negotiations in December 1996. It deals with a paradoxical problem of labor mobility that could only arise after the Single-Market program had also effectuated the guarantees of free movement for services. Whereas the free movement of workers had previously given rise to numerous directives and court decisions to assure that foreign workers would receive the wages and social rights available to national workers at the place of work (Ireland 1995; Tsoukalis 1997, ch. 6), the new freedom of cross-border service provision was now to be realized under the ground rules of 'mutual recognition' — meaning that service firms could operate anywhere in the Community under the regulations of their home country. The logical implication was that firms (and even individual workers operating as independent contractors) could provide services abroad while applying the wage rates and social insurance rules of their country of origin — conditions that were particularly attractive to firms located in Portugal, Britain and Ireland, and that had particularly damaging effects on the construction industries in high-wage countries such as Germany, France or Austria.

The solution finally arrived at was a Council directive that, essentially, allows countries of destination to require all firms operating on their territory to pay at

least the minimum wages generally applicable at the place of work. The directive has the effect of suspending some of the legal consequences of service liberalization — provided that the country affected is interested in, and domestically capable of,⁴ taking advantage of that option. In that sense, its logic is similar to that of the 'safeguard clause' in Art. XIX of the GATT that allows countries to defend themselves against sectoral crises caused by free trade — an option that is not generally available to the member states of the European Community.

4.2 Court and Commission

Finally, there are by now also a number of cases showing that either the Commission or the European Court of Justice are beginning to limit the reach of negative integration and of European competition law, especially in the *service public* areas. In fact, the Amsterdam 'Declaration' on the status of German public banks did merely take note of 'the Commission's opinion to the effect that the Community's existing competition rules allow services of general economic interest provided by public credit institutions existing in Germany...' In other words, the Commission itself had refused to intervene against the distortion of competition that allegedly follows from the fact that the operation of these public banks is secured by assets of the local and regional governments that own and use them for industrial policy purposes. Similarly, the Amsterdam 'Protocol' on Public Service Broadcasting was adopted against a background in which the Commission had not yet acted against publicly financed networks that were also allowed to compete for advertising revenue against their private counterparts. In both instances, therefore, the Commission itself had proceeded with caution, rather than extending competition rules to their logical conclusion, and in that sense, the Amsterdam declarations and protocols were not doing much more than to express approval and political support for the existing practice of self-restraint.

Since the Commission remains a political actor, even if its accountability is weakly institutionalized, it is perhaps to be expected that it will hesitate to apply the syllogisms of competition law regardless of the political salience of countervailing concerns. But to the great surprise of the legal profession (Reich 1994), the Court itself also seems to have done just that in the famous *Keck* decision⁵ that refused to intervene, on the basis of the *Cassis* doctrine, against

⁴ The solution is unproblematic in countries with statutory minimum wages but creates new difficulties in countries like Germany, where collective-bargaining agreements are customarily, but without legal obligation, applied even by firms that do not belong to an employers' association.

⁵ Joined Cases 267/91 and 268/91, *Keck and Mithouard*, (1993).

national rules regulating the marketing of products, rather than product quality. Similarly, after foreign carriers had gained the right of free *cabotage* through the liberalization of road haulage, the Court quite unexpectedly allowed the continuation of compulsory national tariffs, provided that they did apply to foreign and domestic firms alike.⁶ Finally, and most important in the present context, the Court also accepted the possibility that the granting of monopoly rights to the postal service and to regional suppliers of electricity (with the consequence of excluding competitors from commercially profitable services) might be acceptable if justified by a need to cross-subsidize unprofitable services in rural areas.⁷ In other words, the Court itself had begun to strike a balance between the goals of competition law and the purposes served by national *service-public* arrangements (Gerber 1994), well before the Amsterdam Summit explicitly requested it to do just that.

There is reason to think, therefore, that with the completion of the Internal-Market program and its extension into core areas of existing (and highly diverse) *service-public* solutions of nation states, political sensitivity to the risks associated with the single minded maximization of free market competition has increased, not only among member governments but also in the Commission. At the same time, the European Court of Justice has also begun to develop conceptual instruments that allow it to consider the relative weight that should be accorded, in light of the specific circumstances of the individual case, to the competing concerns of undistorted competition on the one hand, and the distributive, cultural or political goals allegedly served by, say, postal monopolies, subsidized theaters, or public television on the other hand.

It is true that the Court's 'balancing test' has not yet produced explicit criteria that would provide clear guidelines to lower-court judges (Hancher 1995) or national policy makers and the Commission, for that matter (Maduro 1997). For the time being, however, that may be just as well. The 'creative ambiguity' created by the Court's dicta and the Amsterdam resolutions is likely to sensitize the zealots of undistorted competition in DG IV and elsewhere to the opportunity costs of their pursuit of legal syllogisms; at the same time, however, the ambiguity of the new rules may still appear sufficiently threatening to the pro-

⁶ Case 185/91, *Bundesanstalt für den Güterverkehr and Reiff* (1993). Ironically, the German *Bundestag*, anticipating a negative ruling of the ECJ, had unanimously repealed the legislation before the case was decided (Héritier 1997).

⁷ See, Case 320/91P, *Procureur du Roi and Paul Courbeau* (1993) with regard to the Belgian postal monopoly, and Case 393/92, *Gemeente Almelo v. Energiebedrijf IJsselmij NV* (1994) with regard to the exclusive-supplier contracts of a Dutch electricity network. Both cases had come to the Court on a preliminary-opinion procedure, and both were remanded for additional factual clarification.

tectionist proclivities of national policy makers to encourage the search for solutions that will achieve national purposes without doing so at the expense of their neighbors. In other words, what one might hope for are approximations of what I had described in an earlier article as the bi-polar criteria of 'community and autonomy' (Scharpf 1994; see also, Joerges 1996; Joerges/ Neyer 1997). Under present conditions, so it is suggested, European integration can only proceed under rules of 'federal comity', where European policy of negative as well as positive integration must respect the need for autonomous solutions at the national level that reflect idiosyncratic preferences, perceptions, policy traditions and institutions. At the same time, however, national actors must respect the fact that they are members of a community of nation states that must take each others' interests and the commitment to a common venture into account when arriving at their autonomous solutions. If these complementary commitments are translated into law, the appropriate instrument can only be a balancing test whose specific implications must unfold through the case-law logic of inductive generalization from one well-considered precedent to another (Holmes 1881).

My conclusion is, therefore, that the dangers arising from the direct (legal) effect of negative integration on national problem solving capacities are now better understood and less likely to get out of hand than could have been expected a few years ago. That, however, does not reduce the indirect (economic) effect of increased transnational mobility and competition on the regulatory and taxing capacities of the nation state. Elsewhere (reference to the other Scharpf policy paper here) I have discussed national policy options that might be more robust against the economic pressures of regulatory competition than existing solutions. But these will only go so far, and the interest in positive European integration remains alive among those groups and political parties that in the past have benefited from state intervention in the capitalist economy.

In the remaining sections, I will therefore discuss strategies that might increase the European contribution to problem in ways that are less likely to founder on conflicts of interest or ideology among national governments in the Council. Among these, 'package deals', and 'side payments' in the form of EC structural and 'cohesion' funds, have in the past played a considerable role in obtaining the agreement of governments that would otherwise oppose each other (Haas 1980; Kapteyn 1991). Under the present fiscal constraints of the EU and its member states, however, these opportunities appear to be more limited, and they will be even less available under the likely conditions of Eastern enlargement. I will not discuss them further here. Instead, I will explore the potential of varieties of 'differentiated integration' for facilitating European action in policy areas of high problem-solving salience and divergent national interests.

5. *Differentiated Integration*

At least since Willy Brandt's suggestion of a two-tier or two-speed Community was taken up in the Tindemans Report (1975), the idea that positive integration could be advanced by some form of differentiation among the member states has been on the agenda of the European Community. But the notion of what criterion should be decisive for assignment to the metaphoric upper or lower echelon, to the vanguard or the rearguard, or to the core and the periphery, of European integration was always oscillating between an emphasis on the political *willingness* of countries to renounce national sovereignty and to commit themselves to closer integration on the one hand, and an emphasis on the economic *capacity* of countries to survive more intense competition or to meet more demanding standards of performance (Grabitz 1984; Giering 1997).

Since these conflicting perspectives were never resolved one way or another, the notion of differentiated integration has retained its connotation of second-class citizenship, even after 'opting out' from common European commitments had achieved a degree respectability from the British and Danish precedents. At any rate, the results of the Intergovernmental Conference leading up to the Amsterdam Summit, which had 'closer cooperation' and 'flexibility' as one of the major items on its agenda, turned out to be very disappointing. With regard to matters within the domain of the European Community (as distinguished from the second and third 'pillars' of the European Union), closer cooperation is among members states is now possible within the institutions, procedures and mechanisms of the Treaty, but its potential range is closely circumscribed by the requirements that cooperation

- must always include at least a majority of member states, and that any other member state may later join on application to the Commission; that it
- must be authorized by a qualified majority in the Council, and even then can be vetoed by a single government; that it
- must not affect Community policies, actions or programs; and that
- it must not constitute a restriction of trade or distortion of competition between member states.

If these conditions are to be respected, closer cooperation will not provide new opportunities for positive integration in policy areas where European solutions are presently blocked by fundamental conflicts among member governments. There are three types of such conflicts that may involve either:

- ideological disagreement over the proper role of the state vis-à-vis the economy, and the proper role of the European Union vis-à-vis the nation state; or
- fundamental conflicts of economic self-interest arising from very large differences in the level of economic development as well as from structural differences in the ability to profit from unrestrained competition; and
- disagreement over the content of common European policies arising from fundamental differences in existing institutional structures and policy patterns at the national level.

In the past, these conflicts have impeded or blocked European solutions in a number of critical policy areas where national solutions are impeded or blocked by negative integration and the economic pressures of regulatory competition. These policy areas include

- environmental process regulations that significantly increase the cost of production of products which are exposed to international competition;
- industrial-relations regulations that are perceived as interfering with managerial prerogatives or as reducing the flexibility of labor markets;
- social-policy regulations that are perceived as raising the cost of production or increasing the reservation wages of workers; and
- the taxation of mobile factors of production, of capital incomes, and of the incomes of internationally mobile professionals (reference here to the other Scharpf working paper).

It is not obvious that any of these issues could be dealt with more effectively under the rules and procedures of closer cooperation and flexibility as they were adopted at Amsterdam. In the sections following below, I will instead discuss a number of strategic approaches that could allow progress to be achieved on these conflict-prone issues even within the present institutional structures and procedures of the Community. I will begin with the possibility of adopting non-uniform standards for environmental process regulations.

5.1 Regulations at Two Levels?

Highly industrialized countries are generally affected by higher levels of environmental pollution (and contribute more to global pollution) than less developed countries. At the same time, the higher productivity of their firms, and the greater ability to pay of their consumers or taxpayers, allow the advanced countries to adopt stringent emission standards. However, if these same standards

were also applied in less developed countries, they would either destroy the competitiveness of their firms or overtax the ability to pay of consumers and taxpayers. As a consequence, agreement on regulations at high levels of protection is difficult or impossible to obtain, and the European record in the field of environmental process regulations is spotty at best (Golub 1996a; 1996b; 1997).

But why should that matter if countries with more serious pollution problems and a preference for more stringent regulations remain free to adopt the standards that are appropriate to their conditions? Since their higher costs are compensated by higher productivity, the threat of competition from less productive economies with lower levels of pollution control should not, in principle, deter them from doing so. What matters very much, however, is the regulatory competition among countries producing at roughly the same level of average productivity. Even if, for reasons the result is not a 'race to the bottom', the threatening loss of international competitiveness has become a practically unbeatable 'killer argument' against all proposals to *raise* the level of environmental process regulations, or of 'green' taxes, by unilateral action at the national level.

The impasse might be avoided, however, by a specific variant of the idea of a 'two-tier Europe' which would allow the adoption of European regulations defining different levels of protection, rather than a single, uniform emission standard for all member states. As far as I know, this possibility has not been specifically considered in the Intergovernmental Conference. Nevertheless, its underlying logic is by no means alien to the universe of European policy options which, typically in negotiations over the entry of new members, include a considerable variety of techniques for softening or postponing the impact of the full *acquis communautaire* on countries that would face specific difficulties in adjusting.⁸ Moreover, articles authorizing Community action may include specific 'safeguard clauses' allowing temporary exemptions for states that are not yet ready to shoulder the full load. A specific example is provided by Article 130s, V TEC, which allows for temporary derogations and/or financial support from the cohesion funds if environmental policy measures should involve 'costs deemed disproportionate for the public authorities of a member state'.

However, all of these techniques maintain a pretense of universality, and they are narrowly constrained by the need to show that the differences allowed are temporary. As a consequence, countries that could not economically afford high levels of protection must try either to block European action, or to soften the impact of European regulations in the process of implementation. The price of

⁸ Overviews of such solutions are provided by Nicoll (1984), Langeheine/Weinstock (1984), and, most comprehensively, Ehlermann (1984).

imposing uniform rules on non-uniform economic constellations is then paid in terms of non-uniform patterns of implementation that are very difficult to control and which, if not controlled, are likely to erode the willingness to enforce, or to obey, European rules in other countries as well. This could be changed by an explicit and general acknowledgment of the differences in the state of economic development and average productivity among the member states of the Community, and of the fact that these also imply differences in the ability to absorb the cost of regulations affecting production processes.

Once that premise is accepted, the solution seems obvious: In order to facilitate the adoption of higher standards, and to eliminate the temptations of competitive deregulation,⁹ there is a need for the harmonization of process-related regulations at the European level — but not necessarily for a single, uniform standard. Instead, there could be two standards, offering different levels of protection at different levels of cost.¹⁰ Countries above a specified level of economic development could then adopt the high standards corresponding to their own needs and preferences. At the same time, less developed countries could also establish common standards at lower levels of protection and cost¹¹ that would still immunize them against the dangers of ruinous competition among each other.

If that possibility did exist, one could expect that agreement on two-level standards will be more easily obtained than agreement on uniform European regulations that would have to be applied equally by all member states. As a consequence, European environmental policy could assume a much more active role than seems presently possible. Conversely, if the Eastern enlargement of the Union is taken into view at all, progress in European regulations of production processes would come to a stand-still unless differentiated standards will allow the less developed countries to survive economically.

⁹ It is remarkable that negative integration in the European Community includes elaborate rules to prevent distortions of competition arising from subsidies, preferential public procurement and other forms of 'affirmative action' favoring national producers — but none against the practices of competitive deregulation and competitive tax reductions.

¹⁰ If instead of technical standards for emissions environmental policy should rely more on 'green taxes' on energy inputs or emissions, it would be plausible to use a sliding scale, rather than two distinct levels of regulation. Thus it has been proposed that the revenue to be raised by an EC-wide environmental tax might be defined as a percentage of GDP in order to avoid disproportionate burdens on the less developed member states (von Weizsäcker 1989).

¹¹ It is true that the Commission's move (at British insistence) from emissions standards to immissions-oriented air quality standards (Héritier et al. 1996) also reduces the regulatory cost of less polluted (i.e. less industrialized or windward) countries. However, wide-ranging or global pollution problems could not be controlled through measures oriented at local immissions.

5.2 A Floor under Welfare Spending?

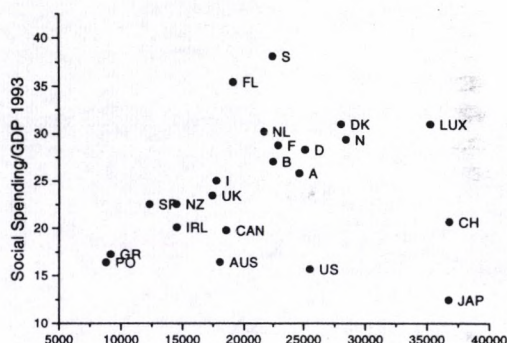
Conceivably, the logic of differentiation may also help to overcome, or at least reduce, some of the difficulties created by regulatory competition in the social policy field. The harmonization of European welfare states is extremely difficult as a consequence of the structural and institutional heterogeneity of existing national solutions. Under these conditions, any attempt at European harmonization would require fundamental structural and institutional changes in most of the existing national systems, and we should expect fierce conflicts over which of the institutional models should be adopted at the European level. In the countries that lose out in this battle, it would be necessary to destroy, or to fundamentally reorganize, large and powerful organizations from which hundreds of thousands of employees derive their livelihood and on whose services and transfer payments large parts of the electorate have come to depend. In short, the political difficulties of harmonizing the institutional structures of mature welfare states would be so overwhelming that it is perfectly obvious why nobody, neither governments nor opposition parties, nor employers associations or trade unions, are presently demanding that the harmonization of social policy should be put high on the European agenda. But does that also rule out a positive European role in the reorganization of existing welfare systems which is presently on all national agendas?

There are indeed options for a reorganization of European welfare states that could reduce mass unemployment and maintain aspirations to distributive justice even under conditions of an internationalized economy, including, for example, the reorganization of rules covering the sheltered sectors of European economies to price low and unskilled labour into work, and the adoption of a negative income tax to offset the consequent loss of income by such workers. But these solutions are difficult to design and to adopt (reference here to other Scharpf policy paper). Under the pressures of regulatory competition and acute fiscal crises, chances are that the changes which are in fact adopted will amount to nothing more than a piecemeal dismantling of existing social benefits. As all countries are now competing to attract or retain investment capital and producing firms, all are trying to reduce the regulatory and tax burdens on capital and firms (S. Sinn 1993; H.-W. Sinn 1994), and all are then tempted to reduce the claims of those groups — the young, the sick, the unemployed and the old — that most depend on public services and welfare transfers.

But in the light of what was said immediately above, how could European decisions make a difference here? If there is any reason for optimism at all, it arises from the observation that, regardless of how much they differ in the patterns of

social spending and in their welfare-state institutions, the member states of the European Union are remarkably alike in their revealed preferences for *total social spending* (measured as a share of GDP). By and large, the richer member states (measured by GDP per capita) have proportionately larger public social expenditures than less rich countries. This is by no means a trivial observation, since it does not hold true for the total set of industrialized OECD countries, for which there is practically no correlation between wealth and welfare spending (Figure 1).

Figure 1: Wealth and Social Spending in OECD Countries



The correlation is much stronger, however, if analysis is restricted to the present members of EU 15 (Figure 2),¹² and it becomes very high if the analysis (based on the latest available 1994 and 1993 data) is limited to the member states of EU 12 (thus eliminating the upper outliers Sweden and Finland which, at that time, were facing very special problems (Figure 3)). By and large, the richer European countries commit proportionately larger shares of their GDP to welfare expenditures than do poorer countries. Thus, if we leave aside Sweden and Finland, past patterns of overall social spending are almost completely explained by differences in the ability to pay.

¹² If GDP per capita is expressed in „purchasing power parities’ rather than in US Dollars at current exchange rates, the correlation is a bit lower, and some countries change positions, but the overall conclusions still hold.

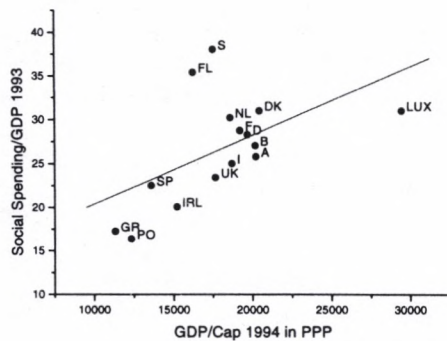


Figure 2: Wealth and Social Spending in EU 15 Member States

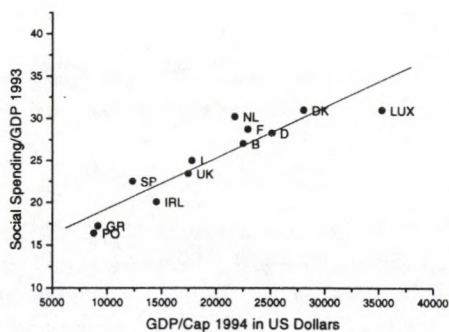


Figure 3: Wealth and Social Spending in EU 12 Member States

These figures suggest the existence of a latent consensus among the member states of the Union, according to which, regardless of structural and institutional differences, the welfare state should increase in relative importance as countries become more affluent. Beyond that, the figures also suggest the possibility that the latent consensus might be transformed into an explicit agreement among European governments according to which all countries would avoid welfare cutbacks that would push their total welfare expenditures below a lower threshold which might be defined at, or slightly below, a line connecting the locations of Portugal and Luxembourg, i.e., the lower outliers in the diagram. If such a rule were in force now, in other words, it would limit the extent to which countries could reduce overall expenditures on social transfers and services, but it would leave them free to pursue whatever structural or institutional reforms they consider necessary above that purely quantitative threshold.¹³ Such an agreement would eliminate the danger (or the promise) of 'competitive welfare dismantling' from the mutual perceptions of European countries, and hence from the range of options that could be considered in debates over welfare reforms at the national level; and it could thus help to liberate national policy choices from the tyranny of regulatory competition.¹⁴

5.3 Coordinated Institutional Reforms?

By itself, however, agreement on a lower threshold of welfare spending would be merely a holding operation that can buy time for the inevitable structural transformation of European welfare states. These transformations will have to be performed at the national level. But they could in various ways benefit from coordination at the European level. These benefits are, perhaps, more obvious for social policy transfers and services provided by the state than they are for

¹³ Two technical problems would require attention, however: First, since welfare spending is highly sensitive to changes in the level of unemployment, reductions of expenditure that are caused by an increase in employment should probably not be counted in defining violations of the threshold agreement. The second is that the definition of what is to be included in the definition of 'Total Social Expenditure' would require much more careful attention than was required for purposes of the OECD study on which the diagrams above are based (OECD 1996) — this will be particularly important at the borderline between what is defined as 'public expenditure', 'mandatory private expenditure' required by statute or by collective-bargaining agreement, and 'voluntary private expenditure'.

But since the agreement as well as the data base on which it depends, will be the product of intergovernmental negotiations that could not succeed unless governments are interested in stipulating effective constraints, they can also make sure that the criteria by which they are willing to be judged fit the specific conditions of the countries involved.

¹⁴ Conceivably, a similar approach, oriented toward the share of GDP contributed to public revenue by taxes on income from capital, could also help to overcome the long-standing blockage of European tax harmonization (Rasch 1996).

industrial relations at the level of the firm and the industry. In fact, however, they are important in either sector of the European welfare state.

Social Policy

Even if welfare-state reforms must be adopted at the national level, it is important for the future of social policy in Europe that the present institutional heterogeneity among national social-policy systems should be reduced. But if institutional heterogeneity presently precludes social-policy coordination, is there any reason to think that it would not also rule out convergent institutional reforms? That would indeed be likely if convergence were to be attempted as a one-step process. The institutional status-quo positions seem too far apart to make negotiated agreement on common solutions a practical proposition. But it might nevertheless be possible to proceed in two steps. At the first stage, one might attempt to reach agreement 'in principle' on the future contours of European welfare systems that are able to assure high levels of employment together with social protection against the risks of involuntary unemployment, sickness and poverty, under conditions of demographic change, changing family structures, changing employment patterns, and intensified economic competition. In fact, as contributions to the OECD High-Level Conference 'Beyond 2000: The New Social Policy Agenda' have shown, these contours are already visible. Proposals from quite diverse quarters seem to converge on a combination of employment-intensive forms of tax-financed basic income support with health insurance systems and (funded) pension schemes that will be financed through individual contributions, part of which will be mandated by law, and subsidized for low income groups (Bovenberg/van der Linden 1997; Esping-Andersen 1997; Haveman 1997). In fact, proposals of this nature, even if they represent radical departures from the status quo, seem to be surprisingly uncontroversial — provided that discussion focuses on the abstract desirability and effectiveness of solutions within a longer-term perspective (OECD 1997).

The difficulties of agreement would, of course, be immensely greater if it should come to the second step of designing ways for getting from here to there — from the divergent status-quo conditions and political constraints of individual countries to a functionally superior and more convergent model of the future European welfare state (Esping-Andersen 1996). But here, the Community might take advantage of the fact that structural and institutional heterogeneity, while extremely great across all member states, is not universal. As Harold Wilensky, Peter Flora, Gøsta Esping-Andersen and others have shown, European welfare states can be grouped into institutional 'families' that share specific historical roots, basic value orientations, solution concepts and administrative practices, and whose path-dependent evolution has required them to cope

with similar difficulties in comparable ways.¹⁵ Without going into any more detail here, within the present European Union it is possible to identify at least four such 'families':

- Scandinavian welfare states which are mainly financed from general tax revenue and which emphasize generous income replacement together with universally available and high quality public services, including public health care;
- Continental systems with relatively generous, income maintaining social transfers and health care financed primarily from employment based social insurance contributions, and with a relatively low commitment to social services;
- Southern systems which represent less comprehensive and less generous versions of the Continental model;
- and the British-Irish system which emphasizes egalitarian and tax financed basic pensions, unemployment benefits and health services, while leaving other forms of income replacement and services to private initiative and the family.

These groupings are certainly not clearly separated from each other. In the Netherlands, for instance, there are elements of the Continental and the Scandinavian models combined, and while Italy corresponds most to the Continental model, its health care system was reformed along British lines in the 1970s and it also shares some of the characteristics of the Southern model (Alber/Schenkluhn- Bernardi 1991). Nevertheless, there is reason to think that among the present members of the Union, there are relatively distinct groups of countries that share important aspects of their welfare state structures and institutions, that are likely to face similar problems, and that will therefore benefit not only from examining each others' experiences, but also from coordinating their reform strategies. If these discussions are managed and monitored by the Commission, it should at least be possible to initiate moves towards greater institutional convergence over the longer term.

¹⁵ See, e.g., Wilensky (1975); Alber (1982); Flora (1986); Esping-Andersen (1990); Alber/Bernardi- Schenkluhn (1991); Castles/ Mitchel (1993); J. Schmid (1996).

Industrial Relations

Coordinated approaches would be equally valuable for the reform of industrial-relations systems, where institutional differences seem to be even more important than in public or state-sponsored social policy areas (Crouch 1993). At present, pressures for reform are felt most acutely in Scandinavian and Continental systems characterized by corporatist arrangements at the sectoral and national level and co-determination at the level of the firm. Since they are most highly institutionalized, they are seen to suffer from severe competitive disadvantages in comparison to the flexibility of purely market-driven Anglo-American systems. Nevertheless, corporatism and cooperative industrial relations have in the past benefited considerably from their capacity to control wage inflation and to raise industrial productivity (Scharpf 1991; Streeck 1992). These advantages are likely to be destroyed as each country responds individually to present pressures for labor-market flexibility and unfettered managerial prerogatives (Streeck 1995; 1997a).

Given the institutional heterogeneity of national systems, there is certainly no chance for creating a universal European industrial-relations regime that would institutionalize sectoral corporatism in all member states or co-determination in the corporate structures of the *Societas Europea* (Streeck 1997). Yet it seems obvious that if reforms could be coordinated among the group of corporatist countries,¹⁶ there would be a much better chance of defining and adopting path-dependent institutional changes that would increase flexibility while still preserving the advantages that cooperative corporatism had enjoyed in the past.

There is reason to think, however, that a still heavier burden of adjustment must be faced by European industrial-relations systems that are neither corporatist nor purely market driven. They seem to be at a competitive disadvantage against both, countries with more flexible labor markets and countries with more disciplined and cooperative unions, and they probably will need to move one way or another, toward the Austrian or the British model, in order to increase their competitiveness and their attractiveness to internationally mobile capital investments. Again, it seems likely that the need for adjustment and the options available could be clarified, and the adoption of reforms facilitated, by coordinated approaches among countries that find themselves confronted with similar problems.

¹⁶ One characteristic disadvantage of corporatist systems is their seeming complexity and lack of transparency for foreign investors, which is greatly increased by the variety of idiosyncratic national corporatisms. At a time when the importance of foreign direct investment increases, therefore, coordination could by itself increase the attractiveness of all corporatist systems.

6. *Needed: Opportunities for Sub-European Coordination*

If the Amsterdam decisions on 'closer cooperation and flexibility' had allowed for the formation of groupings that comprise less than half of all member states, it might have been most promising to use the institutional infrastructure of the Community, and especially the analytical and coordinative services of the Commission, to assist the development of social-policy and industrial-relations reforms which are suited to the specific conditions of groups of countries and, at the same time, would represent convergent moves toward the common longer-term perspective of European welfare states. That would have been a most effective arrangement for counteracting any tendencies toward 'competitive welfare dismantling'. Moreover, and even more important, in the domestic politics of each of the participating countries, the reform of existing welfare systems could have benefited, against ubiquitous opposition, from the legitimacy bonus of internationally coordinated solutions, and perhaps even from the legal force of EC directives.

Under the circumstances, however, the institutional infrastructure that would most facilitate coordination is not in place. The heterogeneity of existing national structures and institutions, and of the specific problems they must face, is far too great to allow the development of uniform reform strategies; at the same time, purely national reform efforts are operating under constraints of international regulatory competition that are likely to allow only suboptimal solutions to be adopted by unilateral reform. Under these conditions, it is nevertheless important to point out that coordinated reform strategies among countries that share critical institutional preconditions are more promising, in principle, than unilateral coping strategies at the national level.

There is a need, therefore, for institutional arrangements that allow countries sharing similar problems to coordinate their reform strategies. Conceivably, some of these benefits could also be achieved through Schengen-type arrangements outside of the institutional framework of the Community — but that would not only lose the organizational support of the Commission but would also presuppose a greater degree of prior consensus among the participating governments than could be expected before the beginning of the analytical and conceptual work that must be done to identify common solutions. But perhaps, as was in the end true of Schengen, if 'closer cooperation' is initiated by some countries outside of the Community framework, then perhaps the next Intergovernmental Conference will again find a way of incorporating such arrangements in the constitution of the European Union.

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